90-986

No. 90-——

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ARMCO EXPORT SALES CORPORATION, *et al.*,
Petitioners,

v.

COMPTROLLER OF THE TREASURY,
Respondent.

Petition for a Writ of Certiorari to the Court of Special Appeals of Maryland

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Commerce and Due Process Clauses of the United States Constitution preclude Maryland from imposing an income tax on a corporation with no physical presence in the State merely because it is engaged in a unitary business with its corporate parent which is doing business in Maryland?

PARTIES TO THE PROCEEDINGS BELOW

The following were parties to the proceedings below:

Armco Export Sales Corporation	Petitioner-Appellee
General Motors Export Corporation	Petitioner-Appellee
Thiokol International, Inc.	Petitioner-Appellee
Comptroller of the Treasury of the State of Maryland	Respondent-Appellant

STATEMENT REQUIRED BY RULE 29.1

Petitioner Armco Export Sales Corporation was a wholly-owned subsidiary of Armco, Inc. and did not have any subsidiaries. Petitioner General Motors Export Corporation was a wholly-owned subsidiary of General Motors Corporation and did not have any subsidiaries. Petitioner Thiokol International, Inc. was a wholly-owned subsidiary of Morton Thiokol, Inc. and did not have any subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners, Armco Export Sales Corporation ("Armco Export"), General Motors Export Corporation ("GM Export") and Thiokol International, Inc. ("Thiokol International"), respectfully request this Court to issue a writ of certiorari to review the judgment of the Court of Special Appeals of Maryland entered in this action on May 1, 1990.

OPINIONS BELOW

The opinion of the Court of Special Appeals of Maryland (App. 1a) is reported at 82 Md. App. 429, 572 A.2d 562 (1990). The order of the Court of Appeals of Maryland denying certiorari (App. 19a) is reported at 320 Md. 634, 579 A.2d 280 (1990). The opinion of the Circuit Court of Baltimore City (App. 11a) and the opinion of the Maryland Tax Court (App. 14a) are unreported.

JURISDICTION

The judgment of the Court of Special Appeals of Maryland was entered on May 1, 1990. Petitioners timely petition for writ of certiorari was denied on September 20, 1990. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process Clause of the Constitution, Amend. XIV, § 1 provides: "[N]or shall any state deprive any person of life, liberty, or property, without due process of law."

The Commerce Clause of the Constitution, Art. I, § 8, cl. 3 provides: "The Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes."

Relevant portions of the Annotated Code of Maryland are set forth in the appendix at pages 20a-24a.

STATEMENT OF THE CASE

This case presents the question whether a State may impose an income tax on an out-of-state corporation with no physical presence in the State merely because it is engaged in a unitary business with its corporate parent which does business in the State. When an in-state taxpayer conducts a unitary business both within and without a State, it is settled law that the State may look to the in-state taxpayer's out-of-state activities in apportioning a fair share of the taxpayer's income to the State. In this case, however, Maryland has sought to extend the unitary business principle beyond its accepted confines. It invokes the unitary business principle not as the predicate for establishing a nexus with an in-state taxayer's out-of-state income but rather as the predicate for establishing a nexus with an out-of-state taxpayer.

A. The Nature and Operation of Maryland's Income Tax.

During the tax years at issue in this case (1981-1984),[1] Maryland imposed a tax on the net income of every corporation, domestic or foreign, allocable to the State. Md. Ann. Code art. 81, § 288(b) (1980). A corporation's net income for Maryland tax purposes was its federal taxable income with specified adjustments.[2] If a corporation was engaged in a unitary business within and without the State, its "business income" was apportioned to Maryland by the familiar three-factor formula of property, payroll, and sales. *Id.* § 316(c).[3]

Although providing for the formulary apportionment of the "business income" of a single corporation engaged in a unitary business in the State, Maryland is one of the many States which does not permit combined or consolidated formulary apportionment for a group of affiliated

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[1] Although the court below stated that the assessments at issue were for the years 1981-85 (App. 1a), the years at issue were in fact 1981-84.

[2] The adjustments to federal taxable income included additions for net income taxes paid to other States, the net capital loss carry-back, and municipal bond interest of other States and subtractions for state income tax refunds, interest from United States obligations, and certain foreign source dividends. Md. Ann. Code art. 81, § 280A (Supp. 1984).

[3] A corporation's "business income" was its income other than (1) its income from real or tangible personal property which were allocated to the State in which the property was located, and (2) its capital gains and losses, which were allocated to the State in which the capital asset was located or to the taxpayer's commercial domicile. Md. Ann. Code art. 81, §§ 316(a), (b) (1980). Section 316 was amended effective July 1, 1984, deleting subsections (a) and (b) and the designation of subsection (c), and substituting the phrase "all net income" for "business income." The amendments, which "were intended to clarify the statute," *Ward Europa, Inc. v. Comptroller*, 66 Md. App. 332, 339 n.3, 503 A.2d 1371, 1374 n.3 (Md. Ct. Spec. App. 1986), have no bearing on the issues raised in this petition.

corporations engaged in a unitary business in the State.[4] Rather, Maryland strictly respects the separate identity of each of its corporate taxpayers and determines the taxpayer's Maryland net income solely by reference to that corporation's own activities and without regard to the activities of any of its unitary affiliates.[5]

B. The Treatment of Domestic International Sales Corporations (DISCs) for Federal and Maryland Income Tax Purposes.

In an effort to encourage U.S. firms to increase their exports, Congress amended the Internal Revenue Code of 1954 ("IRC") in 1971 to provide tax incentives to a corporate entity it described as a Domestic International Sales Corporation ("DISC"). Sen. Rept. 92-437, 1972-1 C.B. 610; Conf. Rept. 92-553, 1972-1 C.B. 666. A corporation qualified as a DISC if substantially all of its assets and gross receipts were export related. I.R.C. §§ 992(a), 993. Under federal law, a DISC was not taxed on its income. Rather, 50% of the DISC's income was deemed to have been distributed to its shareholders each year regardless of whether that portion was actually paid to them. Taxes on the remaining income of the DISC were deferred until either the accumulated income was

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[4] Sixteen other States, like Maryland, do not permit combined reporting of affiliated corporations. [1] Multistate Corporate Income Tax Guide (CCH) ¶ 185 (1990). Although some of these States permit consolidated returns, the circumstances under which such returns may be filed is usually quite limited. *Id.* ¶ 188. In any event, the tax liability from a combined or consolidated return is imposed on the in-state corporation, not the out-of-state affiliate which Maryland seeks to tax in this case.

[5] *Chesapeake Industries v. Comptroller*, 59 Md. App. 370, 374, 475 A.2d 1224, 1226 (Md. Ct. Spec. App. 1984) (Art. 81, § 295 "prohibits not only consolidated returns but also combined reporting" and forbids "disregard" of "separate corporate identities"). *See also Comptroller v. Atlantic Supply Co.*, 294 Md. 213, 219-20, 448 A.2d 955, 959 (1982).

actually distributed to its shareholders or the corporation no longer qualified as a DISC.[6]

The federal DISC legislation had somewhat different tax consequences for Maryland tax purposes than it had for federal tax purposes. While federal law provided for the deferral of a DISC's taxable income, Maryland law treated the DISC's taxable income as fully taxable to the DISC. *Ward Europa*, 66 Md. App. at 338, 503 A.2d at 1374; *Comptroller of the Treasury v. Armco, Inc.*, 70 Md. App. 403, 408, 521 A.2d 785, 787 (Md. Ct. Spec. App. 1987). Because Maryland respected the separate identity of each corporation, it amended its Annotated Code in 1978 to exclude the deemed DISC dividends from the parent's net income.[7]

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[6] In 1984, Congress amended the statutory scheme governing taxation of a DISC. These amendments did not affect the taxable periods at issue.

[7] The statute provided:

> (c) Amounts to be subtracted from taxable income.—There shall be subtracted from taxable income of the taxpayer the following items to the extent included in federal income: . . . (7) to the extent that the dividends are included in taxable income, the percentage of dividends received from an affiliated domestic international sales corporation (as defined by the Internal Revenue Code of 1954 § 992(a)), which is equivalent to the percentage that would be excluded if the domestic international sales corporation was not qualified under § 992(a). However, this exclusion shall be available only if at least 50% of the net taxable income of the domestic international sales corporation is subject to Maryland taxation.

Md. Ann. Code art. 81, § 280A(c)(7) (Supp. 1984). In *Comptroller of the Treasury v. Armco, Inc., supra,* the court held that the limitation of the DISC dividend exclusion to cases in which 50% of the DISC's net income was subject to Maryland taxation discriminated against interstate commerce by favoring in-state over out-of-state commercial activity. Cf. *Westinghouse Electric Corp. v. Tully,* 466 U.S. 388 (1984). The court went on to hold that the offending sentence of the statute was severable, 70 Md. App. at 417, 521 A.2d at 792, and thus left intact the basic statutory scheme described in the text.

Accordingly, throughout the periods at issue, Maryland law clearly reflected the legislature's determination to tax the DISC on its own income based on its separate existence as a taxpayer under Maryland's corporate tax law and to exempt the DISC's parent on the deemed dividends received from the DISC.

C. The Proceedings Below.

Petitioner Armco Export, a Delaware corporation, was a wholly-owned subsidiary of Armco, Inc. During the tax years at issue, Armco Export maintained all of its books and records at the offices of its parent in Houston, Texas or Middletown, Ohio. Armco Export had no office, employees, or property in Maryland and did not conduct any business in the State.

Petitioner GM Export, a Delaware corporation, was a wholly-owned subsidiary of General Motors Corporation. GM Export maintained all of its books and records at the offices of its parent in Detroit, Michigan. GM Export had no office, employees or property in Maryland and did not conduct any business in the State.

Petitioner Thiokol International, a Texas corporation, was a wholly-owned subsidiary of Morton Thiokol Inc. Thiokol International maintained all of its books and records at the offices of its parent in Newtown, Pennsylvania or Chicago, Illinois. Thiokol International had no office, employees, or property in Maryland and did not conduct any business in the State.

In May and June of 1988, after several unsuccessful attempts to assess petitioners parents on the deemed dividends received from their respective DISCs,[8] the Comp-

[8] As noted above, see note 7 *supra*, Maryland first attempted to tax the petitioners' parents deemed dividends on the ground that the statutory exclusion for such dividends was limited to dividends from DISCs which earned more than 50% of their income in Maryland. This exclusion was held to be unconstitutionally dis-

troller issued assessments against petitioners for tax years 1981-84. Upon receipt of the notices of assessment, each petitioner filed an appeal with the Maryland Tax Court stating that it had no constitutional nexus with Maryland.

At trial, the critical question before the court was whether Maryland could, consistent with the Commerce and Due Process Clauses, tax an out-of-state corporation based on the fact that its parent conducted business in the State. In its January 1989 oral opinion (App. 14a-16a), the trial court unequivocally rejected the Comptroller's position that each DISC conducted business wherever its parent did. The court observed "that the fact that . . . the parent corporation . . . is doing business in this state . . . standing alone is not sufficient to make the DISC of that corporation taxable." (App. 15a). The court also found that "it would be necessary for the Comptroller to prove that there is some separate nexus of this DISC with the State of Maryland in order to make it taxable." (App. 15a). Since no such nexus existed, the court struck down the assessments against petitioners.

The Comptroller filed an appeal to the Circuit Court for Baltimore City. The principal issue set forth in the Petitioners' brief was: "Whether the Commerce and Due Process Clauses of the United States Constitution and § 316 of Art. 81 of the Annotated Code of Maryland [9] permit the State of Maryland to assess income taxes against Appellees which do not have any office, property or employees or conduct any business activity in Mary-

criminatory. *Id.* Thereafter, in March and April of 1988, the Comptroller issued notices of assessment to petitioners' parent corporations for tax years 1981-84. After petitions of appeal were filed by each parent, the Comptroller acknowledged—as it had to under the Maryland statutory scheme—that it had intended to assess the DISCs directly. The Comptroller therefore dismissed the assessments against the DISCs' parents.

[9] Art. 81, § 316 provides for allocation of business income between in-state and out-of-state activities. See note 3, *supra*.

land during the periods covered by the assessments at issue." In its June 1989 opinion (App. 11a-13a), the Circuit Court affirmed the decision of the Maryland Tax Court, observing that each DISC was a "separate and distinct legal entity" (App. 12a) and that "DISC corporations should be governed by the same rules and regulations permitting taxation of a foreign subsidiary in Maryland separate and apart from its parent Corporation." (App. 12a).

The Comptroller once again appealed, this time to the Court of Special Appeals of Maryland. The principal issue before the court was once again whether the presence in Maryland of an out-of-state subsidiary's parent constituted a sufficient nexus under the Commerce and Due Process Clauses to justify Maryland's assertion of jurisdiction to tax the subsidiary. In May 1990, the Court of Special Appeals reversed the lower courts and held that Maryland had a constitutionally sufficient nexus with the out-of-state DISCs to subject them to the State's taxing power. The court's analysis rested squarely on the ground that the out-of-state DISCs were engaged in a unitary business with their parents:

> The three key elements necessary for constitutional nexus were affirmatively established in each of these three DISC cases. They are:
>
> 1. The parent is engaged in business in Maryland.
>
> 2. The parent is unitary with the DISC.
>
> 3. The apportionment formula is fair.
>
> Activity directly connected to the DISC took place in Maryland in that the goods produced here and sold overseas generated the DISC income. That activity included the assembly of vehicles by General Motors, production of rocket motors by Thiokol, and steel fabrication by Armco.

(App. 8a).

The court admitted that "none of the DISC's performed any services or transacted any business in Maryland." [10] (App. 5a). Nevertheless, the court held that because the parent and DISC conducted a unitary business, the manufacturing activities of the parent in Maryland provided sufficient "nexus" to directly tax the DISC.

The taxpayer's petition to the Maryland Court of Appeals to review the decision of the Court of Special Appeals was denied (App. 19a).

REASONS FOR GRANTING THE WRIT

The Court of Special Appeals of Maryland has upheld an assessment for income tax against out-of-state corporations based solely on the manufacturing activities of the taxpayers' parent corporations in the State. In so doing, the court below has expanded a State's right to tax an out-of-state corporation beyond that ever contemplated by this Court. The ostensible constitutional predicate for the state court's decision—the unitary business principle—has never been employed as a basis for extending the jurisdictional reach of a State's taxing authority to out-of-state entities. Rather, it has served the more modest function of justifying a State's consideration of an in-state taxpayer's out-of-state activities in determining the portion of the in-state taxpayer's property or income that is properly subject to tax.

The Maryland court's revolutionary expansion of the State's taxing power under the purported guise of the unitary business principle raises serious constitutional questions under the Commerce and Due Process Clauses. There is no support in this Court's unitary business decisions for the radical proposition advanced by the court below. Moreover, the court's decision is in conflict with the decisions of other state courts of last resort. Finally, the decision below has enormous ramifications for the

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[10] All sales attributable to the DISC were conducted outside of Maryland.

interstate business community because it suggests, contrary to the settled expectations of corporate taxpayers across the country, that a subsidiary may be subject to tax liability wherever its parent conducts business. For these reasons, this case warrants the Court's plenary consideration.

I. THE MARYLAND COURT'S HOLDING THAT A STATE MAY TAX AN OUT-OF-STATE SUBSIDIARY WITH NO PHYSICAL PRESENCE IN THE STATE MERELY BECAUSE IT IS CONDUCTING A UNITARY BUSINESS WITH ITS IN-STATE PARENT RAISES SIGNIFICANT CONSTITUTIONAL QUESTIONS UNDER THE COMMERCE AND DUE PROCESS CLAUSES.

A. The Decision Below Expands a State's Right To Tax Under the Unitary-Business Principle Beyond That Ever Authorized by This Court.

The court below has held that, under the unitary-business principle, the activities of an affiliated corporation in a State provide a sufficient "nexus" to justify a tax upon a non-resident corporation which has no independent contacts with that State. This assumes that the unitary business principle provides the constitutional predicate for assertion of jurisdiction over an out-of-state corporation. In fact, however, the unitary business principle has never been employed as a basis for jurisdiction over an out-of-state entity and any effort to do so reflects a grave misunderstanding of the constitutional dimension of the unitary business principle.

The unitary business principle derives from this Court's decisions during the last quarter of the nineteenth century sanctioning the "unit rule" for determining the in-state value of the property of railroads, express companies, and other instrumentalities of interstate commerce that conducted business in more than one State. *See, e.g.*, *Pullman Car Co. v. Pennsylvania*, 141 U.S. 18 (1891);

Pittsburgh C. & St. L. Ry. v. Backus, 154 U.S. 421 (1894); *Adams Express Co. v. Ohio*, 165 U.S. 194 (1897); 2 J. Bonbright, *Valuation of Property* chs. XIX-XX (2d ed. 1937). Under the "unit rule," the Court permitted States to ascertain the in-state value of the enterprise by looking to the entire value of the enterprise (including out-of-state values) and apportioning that entire value to the State by a reasonable apportionment formula. The rationale for permitting the States to look beyond their borders in determining the in-state value of the enterprise was that the true value of the property could not be determined without considering it as a "unit," even if that "unit" extended beyond the State's border. The Court rebuffed Due Process and Commerce Clause challenges to such "unitary" assessments because the existence of the "unitary" business conducted across state lines provided the minimum connection or "nexus" between the State and the out-of-state property that was included in the taxpayer's apportionable tax base. At the same time, the Court insisted, again under the rubric of the Commerce and Due Process Clauses, that the amount of property ultimately apportioned to the State must be fair.

These underlying principles are clearly reflected in the Court's modern decisions applying the unitary business doctrine to state income taxes. First, the Court has observed that the unitary business principle supplies the minimum connection between the in-state taxpayer and its out-of-state activities to justify the inclusion of income generated by those out-of-state activities in the taxpayer's apportionable tax base. As the Court declared in *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980), "the linchpin of apportionability in the field of state income taxation is the unitary business principle." At the same time, the Court has insisted that state income tax apportionments must be "fair" in the sense that "the factor or factors used in the apportionment must actually reflect a reasonable sense of how income is generated,"

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 169 (1983), and that it must not produce a "grossly distorted result." *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 326 (1968).

The unitary business principle, then, simply establishes the constitutional basis for a State to include out-of-state values (income, property, or gross receipts) in an in-state taxpayer's apportionable tax base. This Court has never relied upon that principle as a basis for extending a State's tax jurisdiction to an out-of-state taxpayer. In every one of this Court's decisions involving the application of the unitary business principle to corporate net income taxes, the taxpayer was indisputably subject to the State's taxing jurisdiction. *See Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931); *Maxwell v. Kent-Coffey Mfg. Co.*, 291 U.S. 642 (1933); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Mobil Oil Corp. v. Commissioner of Taxes, supra; Exxon Corp. v. Wisconsin Dept. of Revenue*, 447 U.S. 207 (1980); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *F. W. Woolworth Co. v. Taxation and Revenue Dept.*, 458 U.S. 354 (1982); *Container Corp. of America v. Franchise Tax Bd., supra*. The only question in these cases were whether the plainly taxable in-state taxpayer was in fact engaged in a unitary business with its out-of-state subsidiaries and, if so, whether the apportionment was fair. Indeed, petitioners are not aware of a single decision of this Court involving application of the unitary business principle to state taxes—and there are scores of them—in which it has ever been suggested that the unitary business principle could justify the expansion of a State's tax jurisdiction over out-of-state entities.

Professor Jerome Hellerstein reaffirmed this view in criticizing the arguments of some tax administrators who

would rely on the unitary business principle as a basis for imposing use tax collection liability upon an out-of-state seller:

> Commissioner Hoiska and the [Multistate Tax Commission] are seeking to extend the jurisdiction of the states to require the parent company of a unitary business to collect the tax by reason of the subsidiary's activities in the state. Apportionment is not designed to expand a state's taxing jurisdiction. Indeed, taxpayers have long challenged apportionment on that very ground, namely, that through formulary apportionment the states are extending their jurisdiction to tax extraterritorial income and extraterritorial values. In upholding the constitutionality of apportionment, including combined reporting, the courts have consistently rejected the contention that apportionment extends a state's taxing jurisdiction over income or taxpayers. Instead they have held that apportionment, including combined reporting, serves only to determine in an equitable manner the amount of income or other tax measure of a taxpayer that is part of a unitary business that is properly attributable to the state. *Consequently, as a constitutional matter, the unitary business doctrine that underlies apportionment affords no justification for expanding the jurisdiction of a state* . . .

Hellerstein, *Significant Sales and Use Tax Developments During the Past Half Century*, 39 Vand. L. Rev. 961, 981 (1986) (emphasis supplied).

The Maryland court's invocation of the unitary business principle as the basis for asserting tax jurisdiction over out-of-state entities therefore finds no support in this Court's precedents and flies in the face of the theory on which the unitary business principle rests. Indeed, the Maryland court cites only a single precedent of this Court in "support" of its position, *Mobil Oil Corp. v. Commissioner of Taxes, supra*, and that decision in fact lends no support at all to Maryland's case. In *Mobil*, the tax-

payer was admittedly taxable by the State. The only question was whether the State could include in the apportionable tax base of this admittedly taxable corporation dividends that the corporation received from its foreign subsidiaries. The answer to this question, of course, turned on whether the in-state taxpayer was engaged in a unitary business with its subsidiaries. There was no suggestion in the case that the State could impose a tax on the income of the foreign subsidiaries themselves merely because they may have been engaged in a unitary business with their parent.

Moreover, Maryland's entire taxing scheme is premised on the respect for the separate existence of affiliated corporate entities. Each such entity is taxed on the basis of its own identity and without regard to its relationship to its affiliates. Furthermore, the Comptroller ultimately conceded that it erred when it sought to tax petitioners' parents directly. Hence there is no blinking the fact that this case raises the question whether an out-of-state corporation—one that is entitled to full respect as a separate entity under the State's tax laws—may be subjected to the State's taxing jurisdiction merely because it is engaged in a unitary business with its parent.

In sum, Maryland's unprecedented attempt to employ the unitary business principle as a basis for jurisdiction over an out-of-state corporation with no physical presence in the State raises serious Commerce and Due Process Clause concerns. The most fundamental limitation on state taxing jurisdiction, which is embodied in both the Commerce and Due Process Clauses, is that there must be "some definite link, some minimum connection between a State and the person, property, or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954) (Due Process Clause); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 277-79, 287 (1977) (Commerce Clause). The decision of the Maryland court ignores these limits in its misguided reliance

on a principle that cannot be invoked, as a matter of either theory or precedent, as grounds for expanding a State's jurisdiction to tax.

B. The Decision Below Conflicts With Prior Decisions of This Court.

Wholly apart from its misconception of the proper function of the unitary business principle, the Maryland court's decision conflicts with decisions of this Court holding that the Due Process Clause precludes a State from asserting jurisdiction over an out-of-state corporation merely because an affiliated corporation is doing business in the State. For example, in *Cannon Manufacturing Co. v. Cudahy Packing Co.*, 267 U.S. 333 (1925), a subsidiary was formed to market the products of its parent by purchasing the parent's products and selling them to dealers. Although recognizing that the corporate separation was adopted solely to secure the parent an advantage under local law, this Court refused to ignore the subsidiary's separate corporate existence and held that a corporation could not be deemed to do business in a State simply because a related corporation does business in that State.

Similarly, in *Keeton v. Hustler Magazine*, 465 U.S. 770 (1984), the Court noted that:

> [J]urisdiction over a parent corporation [does not] automatically establish jurisdiction over a wholly-owned subsidiary . . . Each [corporation's] contacts with the forum state must be assessed individually.

Id. at 782 n.13. See also *Peterson v. Chicago, R.I.*, 205 U.S. 364 (1907); *Philadelphia and Reading Co. v. McKibben*, 243 U.S. 264 (1917); *People's Tobacco Co. v. American Tobacco Co.*, 246 U.S. 79 (1918); *Consolidated Textile Corp. v. Gregory*, 289 U.S. 85 (1933); *Rush v. Savchuk*, 444 U.S. 320 (1980).

The Maryland court's holding that a subsidiary is subject to the State's tax jurisdiction because its parent is

doing business there disregards these fundamental due process principles. These principles cannot be dismissed merely because petitioners qualified as DISCs under the Internal Revenue Code. As noted above (see p. 4), Maryland accords these corporations the same independent respect and subjects them to the same tax obligations that other corporations receive under Maryland law.

Furthermore, in an analogous context, this Court has observed that a State lacks the power to tax the income of an out-of-state DISC despite the taxable presence in the State of its parent. In *Westinghouse Elec. Corp. v. Tully, supra,* the Court considered New York's method for taxing DISCs. The taxing scheme adopted by New York, in contrast to the Maryland scheme, combined the income of the DISC and its parent in substantial disregard of the DISC's separate corporate identity. In its opinion striking down New York's tax as unconstitutionally discriminatory, the Court indicated that had New York followed Maryland's approach in taxing the DISC on the basis of its separate corporate identity, New York would have lacked the constitutional power to tax an out-of-state DISC, notwithstanding the undisputed presence of the DISC's parent (like Westinghouse) in the State:

> The State considered two possible methods of DISC taxation. Under the first, a DISC would be taxed directly on its income. Use of this method would encourage formation of DISCs outside the State, *so that New York would obtain no tax revenue from them.*

466 U.S. at 394 n.4 (emphasis supplied).

In seeking to tax an out-of-state corporation with no independent nexus in the State, Maryland has thus transgressed long-standing precepts embodied in this Court's decisions. The decision below conflicts with this Court's decisions precluding the assertion of state tax jurisdiction over one corporation on the basis of the in-state activity

of its affiliate. Moreover, it ignores this Court's explicit recognition in *Westinghouse* that a State lacks the power to impose a tax on an out-of-state DISC merely because of the taxable presence of its parent.

C. The Decision Below Is in Conflict With Decisions of Other State Courts of Last Resort.

The decision of the court below is also in conflict with the decisions of other state courts of last resort. In *Gross Income Tax Division v. Fort Pitt Bridge Works*, 227 Ind. 538, 86 N.E.2d 685 (1949), the Supreme Court of Indiana held that:

> Unless the activities, which are the subject of a tax, are carried on within the territorial limits of the taxing state *by the one sought to be taxed*, that state is without jurisdiction to impose the tax, and to do so, constitutes a violation of the fourteenth amendment to the Constitution of the United States.

Id. at 688 (emphasis supplied). See also *International Elevator Co. v. Thoresen*, 58 N.D. 776, 228 N.W. 192 (1929); *Newport Company v. Tax Commissioner*, 219 Wis. 293, 261 N.W. 884 (1935); *Suttles v. Northwestern Mutual Life Insurance*, 193 Ga. 495, 19 S.E.2d 396 (1942); *Southern Pac. Co. v. McColgan*, 68 Cal. App. 2d 48, 156 P.2d 81 (1945).

In *Sternberg v. O'Neil*, 550 A.2d 1105 (1988), the Supreme Court of Delaware held that:

> Jurisdiction over a wholly-owned [subsidiary] does not automatically establish jurisdiction over the parent corporation in *any* forum . . . Therefore, both the parent and the subsidiary corporations contacts with the forum state must be assessed individually.

Id. at 1119-1120; See also *State v. Northwest Magnesite Co.*, 28 Wash. 2d 1, 182 P.2d 643 (1947).

In holding that jurisdiction over a parent corporation automatically establishes jurisdiction over its wholly-owned subsidiary, the decision below conflicts with the decisions of other state courts of last resort.

II. THE DECISION BELOW HAS FAR REACHING IMPLICATIONS.

The decision below expands the unitary business principle to enable States to directly tax out-of-state corporations with no physical presence there. The implications of this decision are extraordinary. If allowed to remain on the books undisturbed, the decision would justify the assertion of state tax jurisdiction over any out-of-state corporate entity, however removed its activities may be from the taxing State, so long as some unitary affiliate of that corporation was engaged in business in the taxing State. It would justify the assertion of use tax collection liability over an out-of-state seller whose unitary subsidiary was doing business in the State, even though the seller had no physical contacts with the State. One has difficulty imagining a more radical change in the jurisdictional rules that have long been thought to govern interstate corporate activity than that advanced by the Maryland court. It is a change that would affect every multicorporate enterprise engaged in business across state lines. For these reasons, and because the lower court's decision is unprecedented as a matter of constitutional law and unsound as a matter of unitary business theory, this decision warrants this Court's review.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX

IN THE COURT OF SPECIAL APPEALS
OF MARYLAND

No. 1145

September Term, 1989

COMPTROLLER OF THE TREASURY

v.

ARMCO EXPORT SALES CORPORATION, *et al.*

MOYLAN, BELL, ROBERT M.,
GETTY, JAMES S.
(Ret., Specially Assigned), JJ.

Opinion by Getty, J.

Filed: May 1, 1990

The Comptroller of the Treasury has filed this appeal from an order of the Circuit Court for Baltimore City affirming a decision of the Maryland Tax Court relating to income tax assessments against three separate corporations. The Tax Court reversed assessments for the years 1981 through 1985 against Armco Export Sales Corp. (Armco); General Motors Export Corp. (GM); and Thiokol International, Inc. (Thiokol).

The issues presented are whether the three corporations are required to pay Maryland corporate income taxes and,

if so, whether limitations bars the assessments for 1981 through 1983?

Each of the corporations is a Domestic International Sales Corporation, or DISC, which is a phantom book entry corporation created under the federal tax laws as a device to encourage exports through an exemption from otherwise taxable profits. By definition, a sales DISC (I.R.C., sec. 993(a)(1)(A)), earns income because it buys goods from its parent company and then resells the goods to an actual overseas customer; a commission DISC earns its income by a contractual agreement with its parent company giving it a percentage of each qualifying export sale made by the parent (I.R.C., sec. 993(a)(1)(c)). In either case, no activity is performed by the DISC to earn the income.

DISC income is taxable income, but if the DISC transactions meet the tests of I.R.C., secs. 991-997, a DISC pays no federal taxes. Instead, a percentage of its income is imputed to the parent company as a constructive taxable dividend; the balance is taxable to the parent when it is actually distributed as a dividend. In short, DISC's are an approved device designed to defer paying the full amount of tax due when the income is received. This artificial accounting between related corporations is an exception to the general rule, I.R.C. sec. 482, requiring transactions between parent and subsidiary corporations to be arms length dealing.[1]

The following facts are applicable to each of the three corporations involved herein.

Each is a DISC; none of the three has ever filed a Maryland corporation income tax return or paid corpo-

[1] The 1984 Tax Reform Act substantially altered DISC's. They were replaced by "Foreign Sales Corporations" which are to be, unlike DISC's, real operating corporations. The change, however, has no bearing on this case, due to its effective date being after December 31, 1984.

rate income taxes in this state; each is a wholly owned subsidiary of a multinational parent doing business in Maryland and filing a Maryland corporate tax return; each parent is a unitary business with a unitary relationship with its DISC; in all of the tax years at issue (except January, 1981 and January, 1982 for Thiokol) each parent produced goods in this state that were exported outside the United States, generating taxable income for the DISC which, except for the DISC, would have accrued to the parent; none of the DISC's had any tangible assets or employees anywhere; each DISC functioned solely as a bookkeeping entity recording profits from foreign sales by its parent; no DISC or parent companies had its headquarters in Maryland.

GM has an automobile assembly plant in Baltimore. During the tax years in issue, export sales of goods manufactured in Maryland ranged from $39,000,000 to $138,785,000. The accounting and bookkeeping functions for the DISC were performed by headquarters personnel in Detroit, Michigan.

Thiokol is in the rocket and chemical business and has a rocket engine facility in Elkton, Maryland. The DISC's books and records were kept in Marshall, Texas, and sales data would be delivered there by letter or telephone from the parent company.

Armco has steel production facilities in Maryland. Its accounting procedures were handled by its various divisional branches. Armco's Maryland tax returns disclosed the amount of dividends from the DISC to the parent, but not the taxable income of the DISC.

On these facts, the Comptroller asserts that taxation is required by state law and is necessary to reflect the economic reality of DISC transactions. The Tax Court reversed the assessments, reasoning that the Comptroller had failed to establish any nexus between Maryland and the three Disc's. The Comptroller's response to the Tax

Court holding is that a DISC is doing business in Maryland within the meaning of Article 81, sec. 316, and the nexus is established by the parent of the phantom corporation engaged in the export business in the state.

The law relied upon by the Comptroller for imposition of the tax is Article 81, sec. 288(b) and (c), which imposes a tax on any corporation having income allocable to Maryland under the provisions of sec. 316. The latter section allocates income between Maryland and other states by use of an apportionment formula. The factors employed in the allocation are not relevant to the issues herein. The Comptroller finds further authority for taxing the DISC income in *Xerox v. Comptroller*, 290 Md. 126, 142 (1981), which defined the reach of sec. 316 as extending as far as the constitution permits. Thus, the Comptroller claims, if the constitution permits a tax, Maryland imposes it. *See also NCR Corp. v. Comptroller*, 313 Md. 118 (1988).

The Comptroller also cites two recent decisions of this Court involving DISC's, *Ward Europa Inc. v. Comptroller*, 66 Md. App. 332 (1986), and *Comptroller v. Armco, Inc.*, 70 Md. App. 403 (1987). In *Ward*, this Court (Bloom, J.) allowed a modification of the formula in calculating the tax due from a DISC. Expressing legislative intent, Judge Bloom said:

> We do not believe that the legislature intended as bizarre a creature as a DISC to escape all tax liability in this State, and we shall not interpret the statute in question to produce such a result.

66 Md. App. at 344.

In *Armco*, we said (Pollitt, J.) in footnote 11:

> Armco did not actually endure a double tax because its DISC paid no corporate income tax. . . . There would have been no constitutional bar to taxing Armco's DISC, however, as all DISC's face the same

> tax consequences regardless of how much of their income is subject to Maryland tax.

70 Md. App. at 413.

We agree that the DISC in *Ward* was subject to tax, but a significant difference between Ward and the three DISC's involved herein lies in the fact that Ward's only place of business was located in Maryland, and whatever activity was performed by the DISC occurred here. In the present case, none of the DISC's performed any services or transacted any business in Maryland.

The question then arises, do we construe the footnote in *Armco* as establishing that every DISC whose parent conducts business in Maryland is subject to taxation? The issue of taxing Armco's DISC was not before the Court and the holding of the case was that sec. 280A(c)(7) of Code Article 81 is unconstitutional because it discriminated against parent corporations who conduct less than 50% of their business here by denying them the same tax exclusion granted corporations doing more than 50% of their business in Maryland.

We said, in *Armco*, that until 1978 the Maryland tax scheme did not contain any special provision for DISC's. Without legislation clarifying the status of DISC's, the possibility, if not the probability, of double taxation was readily apparent. The state could tax the DISC's allocable income when it was in the "hands" of the DISC and then tax the allocable "deemed distributed income" a second time when the income was, by a bookkeeping entry, transferred to the parent.

The General Assembly attempted to remedy the problem by repealing and re-enacting Art. 81, sec. 280A(c), in 1978. The title to the Act states that its purpose is to

> tax dividends received by a Maryland corporation from the earnings of an affiliated subsidiary domestic international sales corporation (DISC) to the

same extent as dividends received by Maryland corporations from any other affiliated corporation.

As amended, the first sentence of sec. 280A (c) (7) provides:

> (c) There shall be subtracted from taxable income of the taxpayer the following items to the extent included in federal income. . . . (7) to the extent that the dividends are included in taxable income, the percentage of dividends received from an affiliated domestic international sales corporation (DISC) as defined by Internal Revenue Code of 1954 sec. 992(a) which is equivalent to the percentage that would be excluded if the domestic international sales corporation was not qualified under sec. 992 (a).

What the Legislature is saying with all of the above is that since the income is taxable to the DISC, the parent is entitled to exclude the income from its return. Art. 81, sec. 280A (c) (7), therefore, clearly expresses a legislative intent to tax income received by a DISC. We found unconstitutional that part of sec. 7 that granted the exception to only those corporations doing 50% or more of their business in Maryland. The challenged portion, however, does not in any manner intrude upon the legislative intent.

Nexus

The Fourteenth Amendment to the United States Constitution prohibits a state from imposing a tax on an entity in the absence of some connection or nexus with the taxing state. If nexus is established, a state may apply a fairly apportioned tax against the unitary income of an affiliate member of a corporate group where a part of the unitary business is conducted by such affiliate within the state. *See Mobil Oil Corp. v. Comm. of Taxes*, 445 U.S. 425 (1980); *NCR v. Comptroller*, 313

Md. 118 (1988); *Xerox Corp. v. Comptroller*, 290 Md. 126 (1981). In *NCR, supra*, at 132, Judge Adkins said:

> The minimal connection necessary to establish nexus "is satisfied by demonstrating the existence of unitary business, part of which is carried on in the taxing state."

The DISC's herein persuaded the Tax Court that nexus to tax DISC's must come from Maryland property, payroll, or sales by the DISC itself. We think that reasoning is flawed due to the very nature of a DISC, which has no tangible property or employees and can only conduct its activity and do business through branches of its unitary affiliated parent. Adopting the DISC view would lead to one of two atypical results: (1) that a DISC is subject to tax in the state of a parent companys' headquarters or incorporation, or (2) that a DISC may not be taxed anywhere, because it has no property or payroll in any jurisdiction.

We note that in *Mobil Oil Corp. v. Comm. of Texas*, 445 U.S. 425 (1980), the Supreme Court stated that "headquarters only" taxation was constitutionally suspect and, even if it could be accomplished, its allowance did not forbid a fairly apportioned tax against the same income by another state. We think the holding in *Comptroller v. Atlantic Supply Co.*, 294 Md. 213 (1982), is also relevant to the nexus issue. Atlantic had no employees or property of its own, but conducted its business through contracts with related unitary corporate affiliates in other states. It purchased Coca Cola at a discount and resold it to its parent's distributing affiliates. The Comptroller sought to have all of its income subject to Maryland taxation, because in the absence of non-Maryland offices, employees, or property, it was not doing business elsewhere. The Court of Appeals rejected this argument, holding that Atlantic was engaged in business in other states through its corporate affiliates in a unitary business. Thus, the Court rejected a "headquarters" limited inter-

pretation of "carrying on a trade or business" and relied upon a transactional analysis of the business being conducted.

The three key elements necessary for constitutional nexus were affirmatively established in each of these three DISC cases. They are:

1. The parent is engaged in business in Maryland.
2. The parent is unitary with the DISC.
3. The apportionment formula is fair.

Activity directly connected to the DISC's took place in Maryland in that the goods produced here and sold overseas generated the DISC income. That activity included assembly of vehicles by GM, production of rocket motors by Thiokol, and steel fabrication by Armco.

Interestingly, the three DISC corporations herein distinguish *Ward*, which authorized a tax on DISC income, because the DISC conducted all of its business through its parent in Maryland. Ward's DISC, however, is no different than any other; it has no property, employees, or payroll. Whatever action is taken is no more than a bookkeeping entry somewhere by, or at the direction of, someone in the parent organization.

The legislative intent to tax DISC's is clearly expressed in art. 81, sec. 280A(c)(7); *Ward* upheld the taxation of a DISC; *Atlantic Supply* granted a benefit to the parent that was conditioned upon the DISC being taxed in this state. The Tax Court and the trial court refused to follow the legislative direction and precedent which in our view is an error of law. Carrying on a trade or business under art. 81, sec. 316, must be construed broadly enough to carry out the legislative intent to tax DISC's. Nexus, therefore, cannot be found wanting for lack of employees or property where, as here, business is conducted in this state on behalf of the phantom corporation by its unitary corporate affiliates.

Limitations

Article 81, sec. 295, requires that every corporation having income allocable to this state under the provisions of sec. 316 shall file a return showing gross income and deductions claimed. None of the DISC's herein filed a return for the years 1981 through 1985. The limitations issue was raised in the Tax Court, but not resolved. The trial court ruled that the limitations defense was available to the DISC's. The court affirmed the Tax Court decision that no nexus was established, hence no tax was owed. We shall address the issue which, unanswered, may spawn another appeal. Md. Rule 8-131; *State Dept. of Assessments and Taxation v. Clark*, 281 Md. 385 (1977).

The auditing of returns and assessment of tax imposed shall be within three years after the filing of a return, according to art. 81, sec. 309. The period of limitations does not apply, however, in the following situations:

> § 309(c)(1) In the case of a false or fraudulent return with the intent to evade tax. . . , or
>
> § 309(c)(2) In the case of a failure to file a return or in the case of filing of an incomplete return, the tax may be assessed at any time.

The DISC's contend that limitations should begin to run with the filing of Maryland returns by their respective parents, because each Maryland return filed by the parent included a federal corporation return which included a Schedule C indicating deemed dividends received by the parent from the DISC. We construe this argument to be that once the government is put on notice of potential liability, limitations begin to run. We have not been provided with any case supporting this concept, neither are we aware of any such authority. The practical difficulty facing taxing authorities in collecting taxes under such a notice is reason enough for its rejection. Every corporation, pursuant to sec. 295, is required to

file a return. That includes phantom corporations. Under sec. 309(c)(2), limitations did not run because the DISC's filed no returns.

JUDGMENT REVERSED.
REMANDED TO THE
CIRCUIT COURT FOR
BALTIMORE CITY FOR
FURTHER PROCEEDINGS
CONSISTENT WITH THIS
OPINION.

COSTS TO BE PAID BY
APPELLEES.

IN THE CIRCUIT COURT FOR BALTIMORE CITY

Case Nos.: CL93582; CL93583;
CL93581

Maryland Tax Court Income Tax Appeal Nos.:
2948, 2940, 2939

COMPTROLLER OF THE TREASURY
INCOME TAX DIVISION,
Appellant

v.

ARMCO EXPORT SALES CORP.,
GENERAL MOTORS EXPORT CORP.,
THIOKOL INTERNATIONAL, INC.,
Appellees

OPINION AND ORDER

The above captioned cases are now pending before this Court upon Appellant's Appeal from the Decision of the Maryland Tax Court. Each of these cases arose out of an assessment made by the Comptroller of the Income Tax Division against the Appellees. From the decision in favor of the Appellees abating the assessments, the Appellants filed this Appeal. These cases were consolidated on April 17, 1989 for the purposes of briefing and argument.

There were two issues presented:

1st Were these Discs subject to the payment of Maryland Income Tax.

2nd Does the Statute of Limitations cover these Discs.

It is mutual agreed:

1st That each of the Appellees is a Disc or Domestic International Sales Corporation under the Internal Revenue Code.

2nd That none of the Appellees have ever filed a Maryland Income Tax Return or paid any Maryland Corporate Income tax.

3rd That each Disc is a wholely owned subsidiary of a large, multi-national parent company that does business in Maryland, and files a Maryland Corporate Income Tax return.

4th That no Disc had any tangible assets (machinery or equipment, etc) or any employees, but functioned solely as a Bookkeeping entity to keep a record of profits made on export sales to none U.S. Buyers.

5th That no Disc or its parent company was incorporated in Maryland or had its parent company headquarters in Maryland.

These cases were set for hearing on June 16, 1989 before this Court, and after hearing oral arguments of counsel, finds on the first issue that each Appellee is a separate and distinct legal entity; that Disc Corporations should be governed by the same rules and regulations permitting taxation of a foreign subsidiary in Maryland separate and apart from its parent Corporation; and lastly that they are mere bookkeeping entities, owning no property or having any employees in the State of Maryland.

On the second issue finds that the parent companies disclosed sufficient information about their Discs to calculate any income tax due based upon apportionment, which was never done.

Accordingly the Statute of Limitations began upon the parent company filing of its Income Tax Returns.

And upon further reviewing the Records, memoranda filed by counsel and arguments of counsel, finds:

1st That there was a genuine dispute of the facts before the Maryland Tax Court; and

2nd That there were sufficient material facts and law submitted to its findings; and

3rd That where there is inconsistent inferences which can be drawn from the same evidence, it is for the agency hearing the matter, to draw the inference therefrom; and

4th That the Decision was not arbitrary or contrary to the law; and

5th That it is certainly not the intention of this Court to substitute its judgment for the expertise of the Tax Court.

It is therefore, this 26th day of June, 1989, Ordered by the Circuit Court for Baltimore City, that the Decision of the Maryland Tax Court be affirmed; and upon the issue of the Statute of Limitation finds that it does take effect upon the filing of the Income Tax by the parent company.

/s/ Meyer M. Cardin
Judge

MARYLAND TAX COURT
34 Market Place
Baltimore, Md. 21202

Income Tax Nos. 2939
2940
2948

THIOKOL INTERNATIONAL, INC.,
GENERAL MOTORS EXPORT CORP.,
ARMCO EXPORT SALES CORP.

- VS -

COMPTROLLER OF THE TREASURY,
INCOME TAX DIVISION

(HEARING ON MERITS)

Baltimore, Maryland
January 19, 1989

BEFORE:

ACTING CHIEF JUDGE WILLIAM B. CALVERT
JUDGE WALTER C. MARTZ, II
JUDGE SUZANNE R. SHERWOOD

APPEARANCES:

On Behalf of Petitioners:

HARRY D. SHAPIRO, ESQUIRE
RICHARD G. SOLOMON, ESQUIRE

On Behalf of Respondent:

JOHN K. BARRY, ESQUIRE

* * * *

[153] (AFTER RECESS)

ACTING CHIEF JUDGE CALVERT: All right, please be seated. The Court has been giving very careful consideration to this whole case. And we, of course, are having some difficulty with it. And what we are striving to do is what we think is correct under the law.

For the purposes of this opinion it is going [154] to run to all three cases; that is Thiokol International, Inc.; General Motors Export Corporation; and Armco Sales Corporation. The numbers of the cases have already been delineated in the Court record.

And the Court, after very careful consideration, has concluded that—and again taking into consideration the arguments that the Comptroller has made that this DISC is really located wherever the parent corporation is located, the Court does not agree.

And the Court has concluded that under the law that number one, that the federal government recognizes these DISCs as being separate and distinct legal entities from the parent corporation.

Again this Court feels that we must treat this situation much the same way as if we were dealing with the taxability of a foreign subsidiary corporation of a unitary corporation that was located and doing business in the state in arriving at this decision.

And we also further find, under the law, that with the federal government recognizing it as a separate entity, that under the doctrine of federal [155] conformity that the State of Maryland must recognize it in the same manner.

Then we feel that the fact that or we find that the fact that the corporation, the parent corporation tha is doing business in this state, that that standing alone is not sufficient to make the DISC of that corporation taxable.

The Court finds that it would be necessary for the Comptroller to prove that there is some separate nexus of this DISC with the State of Maryland in order to make it taxable.

And as such, the Court will sign an order reversing the assessments that were previously made in these cases.

MR. SHAPIRO: Thank you very much, Your Honor.

THE CLERK: Perhaps Mr. Shapiro can submit the order.

MR. SHAPIRO: Sure, I'll submit the order.

THE CLERK: This is the extent of the Court's docket for today, Your Honor.

MANDATE

COURT OF SPECIAL APPEALS

No. 1145, September Term, 1989

COMPTROLLER OF THE TREASURY

v.

ARMCO EXPORT SALES CORPORATION *et al.*

JUDGMENT:

May 1, 1990: Opinion by Getty, J. Judgment reversed. Remanded to the Circuit Court for Baltimore City for further proceedings consistent with this opinion. Costs to be paid by appellees.

May 31, 1990: Mandate issued.

STATEMENT OF COSTS:

In Circuit Court: for BALTIMORE CITY

89055072, CL93582, 89055071
89055073, CL93581, CL93583

Record	180.00
* Total *	180.00 *

In Court of Special Appeals:

Filing Record on Appeal	50.00
Printing Brief for Appellant	115.20
Reply Brief	57.60
Portion of Record Extract—Appellant	2169.00
* Total *	2391.80 *
Printing Brief for Appellee	73.80
* Total *	73.80 *

STATE OF MARYLAND, Sct:

I do hereby certify that the foregoing is truly taken from the records and proceedings of the said Court of Special Appeals. In testimony whereof, I have hereunto set my hand as Clerk and affixed the seal of the Court of Appeals, this thirty-first day of May A.D. 1990.

/s/ Leslie D. Gradet
LESLIE D. GRADET
Clerk of the Court of Special Appeals

Costs shown on this Mandate are to be settled between counsel and *not through this office.*

IN THE COURT OF APPEALS OF MARYLAND

Petition Docket No. 219

September Term, 1990

(No. 1145, September Term, 1989
Court of Special Appeals)

ARMCO EXPORT SALES CORPORATION, *et al.*

v.

COMPTROLLER OF THE TREASURY

ORDER

Upon consideration of the petition for a writ of certiorari to the Court of Special Appeals and the answer filed thereto, in the above entitled case, it is

ORDERED, by the Court of Appeals of Maryland, that the petition be, and it is hereby, denied as there has been no showing that review by certiorari is desirable and in the public interest.

/s/ Robert C. Murphy
ROBERT C. MURPHY
Chief Judge

Date: September 20, 1990

STATUTES INVOLVED

§ 280A. Net income of corporation.

(a) *In general.*—The net income of a corporation shall be the taxable income of such taxpayer as defined in the laws of the United States as amended from time to time and for the corresponding taxable period and in the case of a corporation exempt from taxation under § 501(c) of the Internal Revenue Code, the unrelated business taxable income of such taxpayer as defined in the laws of the United States as amended from time to time and for the corresponding taxable period or in the case of a regulated investment company, investment company taxable income as defined in the laws of the United States as amended from time to time and for the corresponding taxable period, except as hereinafter modified.

(b) *Amounts to be added to taxable income.*—There shall be added to the taxable income of such taxpayer: (1) Net income taxes, and all other net taxes based on income, imposed by the State of Maryland, and any other state, the District of Columbia and any political subdivision of the State of Maryland or any other state; (2) the net capital loss carry-back as defined in § 1212 of the Internal Revenue Code, as amended from time to time; (3) for all taxable years beginning after December 31, 1973, the oil percentage depletion allowance as claimed and allowed under § 613 of the Internal Revenue Code; (4) interest or dividends, (less related expenses), on obligations or securities of any state or of a political subdivision or authority thereof (other than this State and its political subdivisions and authorities); and (5) interest or dividends on obligations of any authority, commission, instrumentality, territory or possession of the United States or of any foreign government, which by the laws or treaties of the United States are exempt from federal income tax but not from state income taxes.

(c) *Amounts to be subtracted from taxable income.*— There shall be subtracted from taxable income of the taxpayer the following items to the extent included in federal income: (1) Operating revenue subject to gross receipts taxes imposed by this article (less related expenses) of public utilities and contract carriers; (2) the amount of any refunds of income taxes paid to the State of Maryland, any other state, the District of Columbia, and any political subdivision of the State of Maryland and any other states; (3) interest income on obligations of the United States and its instrumentalities; (4) any amounts included therein by operation of the provisions of § 78 of the Internal Revenue Code of 1954; (5) dividends received from a corporation in which the taxpayer owns, directly or indirectly, 50 percent or more of the corporation's outstanding shares of captial stock, and which is organized under the laws of a foreign country, and (6) to the extent included, any profit realized from the sale or exchange of bonds issued by this State or its political subdivisions; (7) to the extent that the dividends are included in taxable income, the percentage of dividends received from an affiliated domestic international sales corporation (as defined by Internal Revenue Code of 1954 § 992(a)), which is equivalent to the percentage that would be excluded if the domestic international sales corporation was not qualified under § 992(a). However, this exclusion shall be available only if at least 50 percent of the net taxable income of the domestic international sales corporation is subject to Maryland taxation; (8) expenses incurred for reforestation or timber stand improvement activity as determined under the provisions of §§ 280C and 280D of this subtitle; (9) the dollar amount by which the employer business deduction for employee wages and salaries is disallowed under § 280C of the Internal Revenue Code (relating to targeted jobs credit); and (10) expenses incurred for the purchase and installation of conservation tillage equipment as determined under § 208E of this subtitle.

§ 295. Corporations and associations which shall file returns.

Every corporation and every association (domestic and foreign) having any income allocable to this State under the provisions of § 316 hereof (and not exempted from taxation hereunder), shall file a return stating specifically the items of its gross income and the items claimed as deductions allowed by this subtitle. Corporations and associations which are affiliated shall each file separate returns. Provided, however, that corporations and associations organized or operated for the exclusive purpose of holding title to property and collecting income therefrom and turning said income less related expenses over to a corporation or organization which itself is specifically exempt from the tax imposed under this subtitle by reason of § 288(b) [d] of this subtitle shall notwithstanding, file a return stating specifically the items of its gross income and the items claimed as deductions allowed by this subtitle and shall in addition thereto, file with the said return a certified or photostat copy of its articles of incorporation or association including amendments thereto, a certified or photostat copy of its bylaws and a certified copy of its latest available financial statement including in addition a statement of income and expense if this said statement is not properly reflected in the return as filed and also a certified or photostat copy of the exemption certificate obtained by the corporation or association under the federal revenue law. The Comptroller may, by regulation, prescribe that the articles of incorporation or association may be eliminated as a requirement hereunder after the first filing thereof, provided, however, that any amendments thereto be filed. The penalty provisions of this subtitle shall be applicable to violations hereof. (An. Code, 1951, § 291; 1939, § 235; 1939, ch. 277, § 228; 1945, ch. 796; 1947, ch. 149.)

§ 316. Allocation of corporate income.

The net income of a corporation (domestic or foreign) shall be allocated in the following manner:

(a) *Income from real estate or tangible personal property.*—Income from ground rents, rents and royalties and other income from real estate or tangible personal property permanently located in this State (less related expenses) shall be allocated to this State; and such income from real estate or tangible personal property permanently located outside this State (less related expenses), shall be allocated outside this State.

(b) *Capital gains and losses.*—1. Capital gains and losses from sales of real property located in this State are allocable to this State. 2. Capital gains and losses from sales of tangible personal property are allocable to this State if; (A) the property had a situs in this State at the time of the sale; or, (B) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the state in which the property had a situs. 3. Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer's commercial domicile is in this State.

(c) *Business income.*—The remaining net income, hereinafter referred to as business income, shall be allocated to this State if the trade or business of the corporation is carried on wholly within this State, but if the trade or business of the corporation is carried on partly within and partly without this State so much of the business income of the corporation as is derived from or reasonably attributable to the trade or business of the corporation carried on within this State, shall be allocated to this State and any balance of the business income shall be allocated outside this State. The portion of the business income derived from or reasonably attributable to the trade or business carried on within this State may be determined by a separate accounting where practicable,

but never in the case of a unitary business; however, where separate accounting is neither allowable nor practicable the portion of the business income of the corporation allowable to this State shall be determined in accordance with a three-factor formula of property, payroll and sales, in which each factor shall be given equal weight and in which the property factor shall include rented as well as owned property and tangible personal property having a permanent situs within this State and used in the trade or business shall be included as well as real property. The Comptroller of the Treasury shall have the right, in those cases where circumstances warrant, to alter any of the above rules as to the use of the separate accounting method or the formula method, the weight to be given the various factors in the formula, the manner of valuation of rented property included in the property factor and the determination of the extent to which tangible personal property is permanently located within the State. (An. Code, 1951, § 312; 1939, § 253; 1939, ch. 277, § 246; 1941, ch. 912, § 253(b); 1951, ch. 597, § 253 (b); 1968, ch. 656, § 1.)

(3)

No. 90-986

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ARMCO EXPORT SALES CORPORATION, *et al.*,
Petitioners,

v.

COMPTROLLER OF THE TREASURY,
Respondent.

Petition for a Writ of Certiorari to the Court of Special Appeals of Maryland

---

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Does a State have nexus to impose a fairly apportioned income tax on export profits when the exported goods are manufactured in the taxing state by a parent company, and all of the activity to earn the income is performed by the parent company of the wholly owned subsidiary that is taxed?

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BRIEF IN OPPOSITION

Comptroller of the Treasury of the State of Maryland, Respondent, for reasons detailed herein, urges the Court to deny issuance of a Writ of Certiorari to the Court of Special Appeals of Maryland to review the judgment in *Comptroller of the Treasury v. Armco Export Sales Corporation*, et al., 82 Md. App. 429, 572 A. 2d 562 (1990).

STATEMENT OF THE CASE

Each of the Petitioners herein is a Domestic International Sales Corporation ("DISC") authorized under I.R.C. § 991 et seq. A DISC is a tax shelter subsidiary permitted to operate as a phantom corporation; its sole function is to book profits on export sales that are actually made by the parent company. A DISC will typically have no tangible property or employees of its own; all transactions that yield income nominally earned by the DISC are conducted by and in the name of the parent company.

Thus, when the parent company manufactures a widget and then sells it to a non-U.S. buyer the sole function of the DISC is to record in a separate corporate entity the profit on that sale, the precise amount of which is determined under the Internal Revenue Code.

Each Petitioner herein fits this pattern. Each one was a subsidiary of a large multinational parent company that had manufacturing facilities in Maryland from which a concededly unitary business was conducted; each one manufactured products in Maryland that were exported so as to yield DISC income. Each Petitioner functioned solely as a bookkeeping entity that had no independent existence of its own; each one "earned" profits pursuant to agreements with its parent company that entitled the DISC to a profit every time a qualifying export sale conducted by and in the name of the parent company occurred.

The one exception to this general rule concerned a practice of one of the Petitioners, Thiokol International, Inc. ("Thiokol"). Rather than keeping all records for the DISC at corporate headquarters (which was different from the state of DISC incorporation) Thiokol actually rented a small second-story walk-up office in Marshall, Texas as an "office" for the DISC, reporting on its 1981 DISC federal tax return rental expense of $1,350 and salary expense of $1,262. The salary expense reimbursed an affiliated company for the service of one of its employees, otherwise employed nearby, who occasionally would go to the "DISC" office and transfer numbers pertaining to the DISC from one book to another. The tax manager for Thiokol's parent company testified on deposition introduced into the record before the Maryland Tax Court that this was done solely for the purpose of inexpensive state tax avoidance, e.g. "We wanted to operate the DISC in a state that did not have a corporate income tax." In the proceedings below Thiokol did not argue that this device entitled them to treatment by Maryland different from the other two Petitioners.

In the proceedings below none of the Petitioners ever claimed that they were not engaged in a unitary business with their parent companies. No Petitioner challenged the fairness of the apportionment formula applied against DISC income, which determined Maryland taxable income by a 3-factor apportionment formula composed of the parent company's Maryland property and payroll, and a zero sales factor that accounted for the non-Maryland destination of goods exported through the DISC.[1] The Petitioners effectively conceded below (Brief of Appellees, p. 25; Pet. for Certiorari to the Maryland Court of Appeals, p. 9-11) that Maryland has constitutional authority (i.e. nexus) to tax a "Maryland" DISC; yet they were never able to suggest in any Court below what is it that makes a DISC a "Maryland" DISC when the DISC will not have employees or property in any state. Finally, the Petitioners did not contend below that the tax herein was forbidden or pre-empted by federal statute, or by the Import-Export clause of the Constitution.

The Maryland Tax Court and the Circuit Court for Baltimore City rejected the Comptroller's contentions that these companies were taxable by Maryland. The Court of Special Appeals reversed the lower courts and sustained the Comptroller's assessments against the Petitioners, holding that the Maryland legislature clearly intended to tax DISC income, and that such tax was not forbidden by the Constitution. The Maryland Court of Appeals denied certiorari, finding that further review was neither desirable nor in the public interest, Md. Code Ann., Courts & Judicial Proc. Art. § 12-203.

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[1] This type of apportionment formula for DISCs was approved by both the Maryland Tax Court and the Court of Special Appeals in *Ward Europa, Inc. v. Comptroller*, 66 Md. App. 332, 503 A.2d 1371 (Md. Ct. Special App. 1986). Maryland uses the destination rule to allocate sales receipts for the apportionment formula, see Code of Maryland Regulations, Title 3, 03.04.03.08C.

ARGUMENT

THE PECULIAR AND CLOSED NATURE OF DISCS MAKE THIS CASE PARTICULARLY INAPPROPRIATE FOR CERTIORARI JURISDICTION

Petitioners concede that income of a DISC is fully taxable under a fair apportionment formula if the tax is levied upon the parent company that owns the DISC and performs all DISC activity. Petition for Certiorari, p. 2. One treatise has noted that Maryland's method of taxing the DISC directly on its income achieves substantially the same result, see *State Taxation, V I, Corporate Income and Franchise Taxes*, Jerome R. Hellerstein (1989 Cum. Supp., (Jerome R. & Walter Hellerstein) ¶ 9.19 [3], p. S537).

Such concession is not surprising; a claim that a state had no nexus to tax DISC income was dismissed on appeal to this Court as not raising a substantial federal question, see *Westinghouse Elect. Corp. v. Tully*, 434 N.E. 2d 1044 (N.Y., 1982), 459 U.S. 1144 (1983), rev'd on other grounds, 466 U.S. 388 (1984).[2] Petitioners therefore seek review so as to procure a ruling from this Court that States may not do directly what Petitioners concede may be done indirectly; that due process requires a particular tax return format in order to achieve nexus. Such review would be an inappropriate exercise of this Court's discretionary jurisdiction.

Certiorari jurisdiction is only to be granted in cases of conflicting decisions in the lower courts, matters of

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[2] Petitioners contend (Petition for Certiorari, p. 16) that this Court indicated a contrary view in *Westinghouse* at 466 U.S. 394, fn. 4. If the entire footnote and accompanying text are considered, it is clear that this Court was not in fn. 4 indicating a view on a constitutional issue not before it, but instead describing the New York statutory history. In any event the DISC at issue in *Westinghouse* was, notwithstanding a fear by New York of "formation . . . outside the State", *id.*, incorporated in Delaware and not in New York.

public importance, or direct conflict with decisions of this Court, Rule 10. None of these standards are met here. The Maryland Courts have merely applied applicable precedent of this Court to find, on the facts of this case, that interlocking activities of unitary affiliates are sufficient to create nexus.

In this case Petitioners assert that the opinion below allows nexus merely because of a unitary relationship, Pet. for Certiorari, p. 9; Respondent contends that nexus over the DISC is established by the specific facts in the record that underlie the unitary relationship, i.e., the activities conducted by the parent company in Maryland "on behalf of the [DISC]", 82 Md. App. 437, 572 A. 2d 567. It is most important to note however, that review of this case will not be particularly helpful in determining when nexus exists over particular subsidiary corporations because of unitary ties; and that there is no evidence from the Petition that this intellectual question is anything more than hypothetical.

This case involved DISCs—peculiar tax shelter entities whose tax benefits under federal law were largely repealed by the Revenue Act of 1984, see Bittker, *Taxation of Income, Estates and Gifts*, ¶ 68.2.5; (1990 Supp.) [3] DISCs are inherently peculiar because they permit the shifting of income from one entity to another without the recipient (or DISC) conducting any activity to earn that income—a practice normally prohibited for ordinary business subsidiaries by I.R.C. § 482. Since the DISC must have its parent act on its behalf it is questionable whether the inter-corporate connections and activities produced thereby (and which create nexus in this case) have relevance to other "real" unitary subsidiaries and the tax

[3] Their replacement as shelter entities for export profits under federal law are foreign sales corporations (FSCs), *Bittker, supra,* ¶ 68.7.2 (1990 Supp.). FSCs (unlike DISCs) are required to have a bona fide overseas presence. Maryland does not view a FSC as an alter ego of its parent, and has no case pending against any FSC.

issues they produce. Maryland, in fact, does not assert nexus over all unitary corporate affiliates because of the physical presence in Maryland of one of them; it instead makes determinations on a case by case basis because of the facts of each, see *Wright & Miller*, Federal Practice & Procedure, V. 4, § 1069, n. 29-31.

The effect of this case is also limited by the interplay between the Commerce Clause and the Due Process Clause. These two constitutional provisions require fair apportionment of DISC income, see *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1974); *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980). This limits the actual tax on DISC income in the 16 non-combined reporting states to the actual presence of the parent company in these states. If large amounts of employees and property are present, the tax may be great; if such presence is small the tax will be small as well.

Consistent with this operational effect the Maryland Comptroller has only 14 DISC cases pending, all in the Maryland Tax Court. Almost all of these taxpayers have agreed to be bound by the ultimate decision in this case, and the majority of cases do not exceed $50,000 in amount.

The effect of the decision below is further limited by the concededly lawful taxation of DISC income on a combined basis with the parent company, and the fact that a majority of states do so. Since the 16 states that do not do so could not retroactively change their tax return format, the utility of a precedent requiring them to adapt a particular type of tax return is questionable—since it could not be ruled upon in such a case how such requirement would apply to non-DISC subsidiaries.

The Petition is based on an erroneous premise. It contends that the decision below rested nexus solely on unitary ties, Petition for Certiorari, p. 9. This was not in fact the reasoning of the Court of Special Appeals. That

Court instead held that nexus exists when: (1) the parent company has an actual presence in the taxing state; (2) it is unitary with a subsidiary that performs *no* activities on its own; (3) events directly connected to the income to be taxed occur in the State, i.e., export production; (4) the parent company acts "on behalf of" the DISC. The decision does not break new ground; it is consistent with and supported by the modern cases in this Court that establish nexus not only by the physical presence in the taxing state of employees or property of the company to be taxed, but also by activities undertaken "on behalf of" the company to be taxed.

The actual activities within a taxing state that must take place for tax jurisdiction to be conferred can be minimal, see *Northwestern States Portland Cement Co. v. Minnesota* and *Williams v. Stockton Valves & Fittings, Inc.*, 358 U.S. 450 (1959); *Standard Pressed Steel Co. v. Washington Dept. of Rev.*, 419 U.S. 560 (1975). The modern statement of the nexus rule by this Court is as follows: "For a State to tax income generated in interstate commerce the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal *connection*' between the interstate *activities* and the taxing state, and a rational relationship between the income attributed to the State and the intrastate *values* of the enterprise." *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980) at 436-437. (emphasis added)

The use in *Mobil* of general words such as "connection", "activities" or "values" was not accidental; this Court has repeatedly pointed out that nexus determinations among interlocking corporations are to be made on the basis of real, underlying events, and not the corporate formalities suggested by the Petition. Thus, nexus is not achieved merely because a dividend has been received, see *Asarco v. Idaho*, 458 U.S. 307 (1982); conversely this Court has sustained a tax on all of the income of a foreign subsidiary engaged in a unitary business, even though no divi-

dend was paid, see *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

The Maryland Court of Special Appeals followed these principles to the letter. It held that the very nature of a DISC, with its lack of employees, property or tangible, bona fide existence *anywhere*, meant that the DISC could and should be viewed as conducting business in Maryland because of Maryland "activities" of its parent that were demonstrated in the record, that related to the income of the DISC, and provided, as expressed in *Mobil*, the "minimal connection" necessary. The Court of Special Appeals expressed this as follows: "Nexus, therefore, cannot be found wanting for lack of employees or property where, as here, business is *conducted in this state on behalf of* the phantom corporation by its unitary corporate affiliates." 82 Md. App. 437, 572 A. 2d 567. (emphasis added). It is not merely that the DISC is unitary with its parent that gives jurisdiction; it is that the parent is effectively the Maryland agent of the DISC, and acts "in this state on [its] behalf," as agents typically do.

This holding is supported by a long line of precedent holding that nexus to tax a company without employees or property in the taxing state can be achieved through activities undertaken on the company's behalf by others, see *Williams v. Stockton Valves & Fittings, Inc., supra*; *Scripto v. Carlson*, 362 U.S. 207 (1960); *People v. United National Life Insurance Co.*, 66 Cal. 2d 577, 427 P. 2d 199, 58 Cal. Rptr. 599, appeal dism'd for want of a substantial federal question, 389 U.S. 330 (1967); *Ministers Life & Casualty Union v. Haase*, 30 Wis. 2d 339, 141 N.W. 2d 287, appeal dism'd for want of a substantial federal question, 385 U.S. 205 (1966); *Illinois Commercial Mens Assn. v. State Bd. of Equalization*, 34 Cal. 3d 839, 671 P. 2d 349, 196 Cal. Rptr. 198 (1983) appeal dism'd, 466 U.S. 933 (1984); *Readers Digest Assn. v. Mahin*, 44 Ill. 2d 354, 255 N.E. 2d 458, appeal dism'd,

399 U.S. 919 (1970); *Comptroller v. Atlantic Supply, Inc.*, 294 Md. 213, 448 A. 2d 955 (1982).

This precedent amply supports nexus over a DISC under the complete control of its parent where the parent conducts all of the activities relating to the DISC, and both export production and activities relating to export production take place in the taxing state. That companies may be taxed because of activities undertaken in the taxing state "on [their] behalf" is so well recognized as to have been afforded a long-standing federal safe harbor from such nexus and tax, see P.L. 86-272, 73 Stat. 555, 15 U.S.C. § 381 (1959);[4] the result below therefore merely implements the well recognized principle that interlocking corporations can, and sometimes do, act on behalf of one another, see *Hellerstein, supra*, 1989 Cum. Supp. § 6.7 [3], p. S111.

This Court wisely limits its cases to real disputes because it recognizes that the best law is made in the context of concrete facts. The Petition offers no evidence in the form of state tax practice or actual recent state tax cases that it is necessary or wise to incorporate into the Constitution a particular tax reporting method; it fails to recognize that it would be doubly unwise to do so in the peculiar context of an unusual corporate device whose existence is rapidly fading into history.

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[4] This statute was enacted in response to this Court's decision in *Northwestern States, supra*. It prohibits a State tax if companies limit both their activities and those undertaken on their behalf. Petitioners do not contend that they come within its terms.

CONCLUSION

For the foregoing reasons, the Petition should be denied.

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PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Respondent's Brief in Opposition seeks to accomplish three objectives. First, Respondent attempts to rewrite the decision below to provide a more favorable factual setting. Second, Respondent attempts to obfuscate the legal issue in this case by relying on precedent which does not consider the jurisdictional reach of a State's taxing authority, but considers only whether out-of-state income may be included in the apportionable tax base of an in-state taxpayer. Finally, Respondent attempts to diminish the far-reaching consequences of the "nexus" test enunciated in the decision below.

Respondent's attempt to obscure the issue should not distract this Court from considering the substantial federal question presented in the Petition. The only issue in this case is whether a State may impose an income tax on an out-of-state corporation with no physical presence in the State merely because it is engaged in a uni-

tary busines with its parent which does business in the State. Because the outcome of this issue will affect every multi-corporate enterprise engaged in a unitary business, it warrants this Court's review.

I. THE COURT BELOW RELIED SOLELY ON THE UNITARY BUSINESS PRINCIPLE TO ESTABLISH A "NEXUS" BETWEEN THE STATE AND PETITIONERS.

In an attempt to muddy the factual record in this case, Respondent contends that "it is not merely that the DISC is unitary with its parent that gives jurisdiction; it is that the parent is effectively the Maryland agent of the DISC, and acts 'in this state on [its] behalf,' as agents typically do." Brief in Opposition at 8.

The fatal flaw in Respondent's argument is that no activities were performed in Maryland on Petitioners' behalf by Petitioners' parent corporations. Rather, all export sales attributable to Petitioners occurred outside of Maryland. The only activities cited by the court below which occurred in Maryland were the "assembly of vehicles by GM, production of rocket motors by Thiokol, and steel fabrication by Armco." [1] App. 8a. But these activities can hardly form the predicate for jurisdiction over Petitioners. Indeed, neither the court below nor the Respondent cite any case in which a parent corporation was deemed to manufacture goods as an "agent" of its sales subsidiary.[2] Thus, this is not a case where the

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[1] The Brief in Opposition implies that all exported goods were produced in Maryland. In fact, only a small amount of the exported goods were actually manufactured in Maryland.

[2] The cases cited by Respondent all involve the question of whether a State's jurisdictional reach extends to an out-of-state corporation which conducts sales activity through various agents in the State. Brief in Opposition at 8. None of them addresses the question at issue here—whether a State has jurisdiction over an out-of-state corporation merely because an affiliated corporation conducts manufacturing operations in the State. See *Cannon Manufacturing Co.*

parent corporations acted as "agents" of the Petitioners in Maryland.

Accordingly, despite Respondent's attempt to create a more favorable factual record, there is no escaping the fact that the sole issue in this case is whether an out-of-state corporation may be subjected to the State's taxing jurisdiction merely because it is engaged in a unitary business with its parent.[3]

II. WHETHER A STATE HAS JURISDICTION TO TAX AN OUT-OF-STATE CORPORATION IS NOT MERELY A QUESTION OF "TAX RETURN FORMAT."

Respondent states that this case is merely a question of "tax return format" because "petitioners concede that income of a DISC is fully taxable under a fair apportionment formula if a tax is levied upon a parent company that owns the DISC and performs all DISC activity."[4] Brief in Opposition at 4.

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v. Cudahy Packing Co., 267 U.S. 333 (1925), in which this Court refused to disregard the separate corporate existence of a subsidiary even though its only function was to collect the purchase price on goods manufactured and shipped by its parent.

[3] Respondent also erroneously asserts that Petitioners "were never able to suggest in any Court below what is it that makes a DISC" taxable in Maryland. Brief in Opposition at 3. In fact, the Petitioners have consistently argued that the DISC is subject to tax in the State within which its books and records are kept.

[4] Petitioners did not concede, as Respondent implies, that a tax upon the DISC income could have been "levied" against the parent corporations. Brief in Opposition at 4. Rather, Petitioners stated that Maryland law strictly respects the separate existence of affiliated corporate entities and determines each entity's net income solely by reference to that corporation's activities and without regard to the activities of any of its unitary affiliates. Petition at 5. In fact, the Comptroller acknowledged that it erred when it sought to tax Petitioners' parents directly. Petition at 6, n.8. Thus, Petitioners' income could not have been included in their parents' tax base under Maryland's taxing scheme.

In support of this statement, Respondent argues that "a claim that a State had no nexus to tax DISC income was dismissed on appeal to this Court as not raising a substantial federal question, see *Westinghouse Elect. Corp. v. Tully*, 434 N.E.2d 1044 (N.Y. 1982), 459 U.S. 1144 (1983), rev'd on other grounds, 466 U.S. 388 (1984)." Brief in Opposition at 4.

The question presented to this Court in *Westinghouse* was not whether New York had "nexus" to tax an out-of-state DISC directly. Rather, the question was whether New York could include the income from an out-of-state DISC in the in-state parent's apportionable tax base under the unitary business principle based upon New York's taxing scheme which permitted the inclusion of a unitary affiliate's income in the apportionable tax base of the in-state taxpayer.[5] There was never any question as to whether the State had jurisdiction over the in-state taxpayer.

As discussed more fully in the Petition at pp. 10-13, the unitary business principle simply establishes the constitutional basis for a State to use out-of-state values as a measure in determining an in-state taxpayer's apportionable tax base. It has never been employed as a basis for extending the jurisdictional reach of a State's taxing authority to an out-of-state entity.[6]

The Respondent's reference to this critical distinction as a matter of "tax return format" underscores the

[5] See Jurisdictional Statement at i, *Westinghouse*.

[6] Respondent's contention that "the Maryland courts have merely applied applicable precedent of this Court to find, on the facts of this case, that interlocking activities of unitary affiliates are sufficient to create nexus," is equally without merit. Brief in Opposition at 5. As discussed in the Petition at 13-14, the only decision of this Court cited below was *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425 (1980), in which this Court held that a State could include dividends received from an out-of-state corporation in the apportionable tax base of an admittedly taxable in-state corporation.

State's inability to grasp the serious Commerce and Due Process Clause issues involved in this case and provides a foreshadow of the grave consequences which will occur if the decision below is left undisturbed.

III. THE "NEXUS" TEST ENUNCIATED BY THE COURT BELOW HAS FAR-REACHING CONSEQUENCES.

The Respondent asserts that because the corporations involved in this case qualified as DISCs under the Internal Revenue Code, it is questionable whether the jurisdictional test enunciated by the court below would have "relevance to other 'real' unitary subsidiaries and the tax issues they produce." Brief in Opposition at 5-6.

This argument is misplaced for three reasons. First, there is nothing in the opinion below that limits its scope to DISCs. Indeed, the court below unequivocally declared that "the elements necessary for constitutional nexus" over the out-of-state DISC were simply that "1. The parent is engaged in business in Maryland. 2. The parent is unitary with the DISC. 3. The apportionment formula is fair." App. 8a. One searches in vain in this rationale for any limiting principle that would confine its application to DISCs.

Second, it is clear under Maryland law that a DISC is afforded the same rights and privileges and is taxed in the same manner as any other corporation. See App. 13a. Hence, there is no foundation in Maryland law for drawing any distinction between the assertion of jurisdiction over an out-of-state DISC and the assertion of jurisdiction over any other out-of-state corporation.

Third, the misguided view of the court below that the unitary business principle creates nexus with an out-of-state subsidiary cannot be dismissed as a holding that is limited to DISCs because it derives from an earlier Maryland decision involving "real" corporations that ex-

pressed similar sentiments. In *NCR v. Comptroller*, 313 Md. 118, 544 A.2d 764 (1988),[7] the Maryland Court of Appeals held that:

> The minimal connection necessary to establish nexus is satisfied by demonstrating the existence of a unitary business, part of which is carried on in the taxing state.

App. 7a. It is therefore apparent that the State court's opinion, insofar as it holds that a State has nexus with an out-of-state corporation merely because it is engaged in a unitary business with its in-state affiliate, cannot be ignored as a juridical sport.

In short, it is plain that the decision below stands squarely for the novel proposition that State tax jurisdiction may be asserted over any out-of-state corporate entity so long as some unitary affiliate of that corporation is engaged in business in the taxing state.[8] If allowed to remain on the books undisturbed, this decision would mark the first time this Court has sanctioned the invocation of the unitary business principle as the predicate for establishing nexus with an out-of-state taxpayer which maintains no physical presence in the State. Accordingly, Maryland's misguided expansion of the unitary business principle should not go uncorrected.

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[7] The issue in *NCR* was whether dividends and interest paid by an out-of-state corporation to NCR could be included in the apportionable tax base of NCR, which admittedly conducted business in the State.

[8] This view is underscored by the filing of a brief amicus curiae by the Committee on State Taxation of the Council of State Chambers of Commerce, which represents 43 State Chambers of Commerce across the nation.

CONCLUSION

For the foregoing reasons, this Court should issue a writ of certiorari to review the judgment of the Court of Special Appeals of Maryland.

Respectfully submitted,

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No. 90-986

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ARMCO EXPORT SALES CORPORATION, *et al.*,
Petitioners,

v.

COMPTROLLER OF THE TREASURY,
Respondent.

On Petition for Writ of Certiorari to the Court of Special Appeals of Maryland

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF OF THE COMMITTEE ON STATE TAXATION OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation of the Council of State Chambers of Commerce as *amicus curiae* in support of the petitioners' petition for writ of certiorari in the above-captioned case. Written consents of the petitioners and respondent have been obtained and filed with the Clerk of this Court.

INTEREST OF *AMICUS CURIAE*

The Council of State Chambers of Commerce (Council), organized in 1932, consists of 43 state chambers of commerce. The Committee on State Taxation (COST), an advisory committee of the Council, consists of 364 corporate members. Most of these corporations have a large number of subsidiaries, each of which conducts business in one or more states.

COST member corporations conduct a substantial portion of the interstate commerce in the United States. The members are representative of that part of the Nation's business sector which is most directly affected by the state taxation of interstate operations. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of corporations and to ensure that states do not exceed constitutional limitations in imposing their various taxes. COST member companies recognize their responsibility to pay their fair share of state tax to the jurisdictions in which they do business. However, COST strongly objects to the expansion of jurisdictional nexus beyond constitutional limits to allow a State to assess a tax against an entity that has no physical presence in that State.

COST member companies have a great concern in seeing that traditional due process nexus standards are observed and maintained. COST members and their unitary subsidiaries are, of course, subject to formula apportionment in those states which have adopted a combined scheme of taxation, but even under such a scheme of taxation non-nexus members of the combined group are not subject to tax. Those members of the combined group are taxed only in the states in which they have nexus. COST members are vitally interested in seeing that the decision of the Maryland Court of Special Appeals, which extends taxing jurisdiction to a corporate entity with no connections to the State, be reversed.

SUMMARY OF ARGUMENT

The only issue before the Court in this case is whether, under the Due Process Clause, a State may impose its taxing jurisdiction over a corporate entity that has no physical presence in that State. In the decision below, the State of Maryland has completely ignored Due Process protections. With absolute disregard to well established principles that a state has no jurisdiction over a person or corporation that has no contacts with that state, the State has issued an assessment against a corporation which it admits has no property or employees within Maryland.

The lower court's decision is mired in its attempt to apply "unitary", a concept used to determine how a state may measure an *in-state* corporation's tax base, to a case in which the only issue is "nexus". Nexus is the term used to describe the minimum contacts necessary under the Due Process Clause for a state to exercise its taxing jurisdiction over an *out-of-state* corporation. The lower court's confused analysis has given us the surreal result in which Maryland has assessed a franchise tax against a corporate entity which has no contact with the State. Such a result is clearly without authority, creates a dangerous precedent for multi-entity taxpayers and must be overruled.

ARGUMENT

THE MISAPPLICATION OF THE UNITARY CONCEPT TO CREATE "IMPUTED NEXUS" VIOLATES THE DUE PROCESS CLAUSE

According to the lower court, the three key elements necessary for constitutional nexus are: 1) the parent of the corporate entity which the State seeks to tax is engaged in business in the State; 2) the parent is unitary with the entity it seeks to tax; and 3) the apportionment factor is fair. Petitioners' App. 8a. Under this analysis, the State claims to have nexus with a corporate entity that has no physical presence in the State. Such "imputed nexus" ignores this Court's "consistent adherence to one time-honored concept: that due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-345 (1954). Thus, "where there is jurisdiction neither as to person nor property, the imposition of a tax would be ultra vires and void". *Id.* at 342, quoting *St. Louis v. Ferry Co.*, 11 Wall. 423, 430. As this Court cogently stated in *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940):

> "Taxable event," "jurisdiction to tax," "business situs," "extraterritoriality," are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state.

Id. at 444. When that test is applied to the present case, it is clear that Maryland has given no protection, opportunities or benefits to the petitioners since they have no physical presence in the State.

The issue in this case is simply whether Maryland can assess a tax against petitioners, who have no physical presence in the State, *not* whether Maryland can constitutionally include DISC income in the apportionable income of the parent corporation which does have presence in the State. Within the appropriate statutory and procedural framework the State may very well be able to include the DISC income it wishes to reach in the parent corporations' taxable incomes.[1] However, the fact that this income might have otherwise been reached by the State does not excuse Maryland from the constraints of the Due Process Clause.

In an attempt to escape these constraints, as well as its own non-combination law, the lower court developed its "imputed nexus" test, based on the unitary concept, a concept which is completely unrelated to the issue of nexus. The unitary concept simply allows the inclusion in the apportionment formula of out-of-state values for the purpose of determining an in-state taxpayer's income. It is the in-state taxpayer's income that is taxed. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); *International Harvester Co. v. Evatt*, 329 U.S. 416 (1947).[2] Significantly, out-of-state income of in-state taxpayers is *not* taxed. It follows that out-of-state income of our-of-state taxpayers should not be taxed.[3]

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[1] As is recognized by the parent corporations of the petitioners, which have filed returns including the DISC income in states in which they do business that require combined unitary filing.

[2] Petitioners have presented a thorough discussion of the development and application of the unitary concept. Therefore, such discussion will not be repeated in the brief of *amicus*.

[3] Obviously, petitioners had no Maryland property, payroll or sales factors to use to apportion any income to the State. To avoid this fatal flaw, the State used the parent corporations' property and payroll factors.

Since the unitary concept does not in fact allow taxation of out-of-state income, the unitary concept, as applied by this Court, has in no way supported that a State has jurisdiction to tax income earned outside the State or to impose a tax on a corporation with no physical presence within the State. *See Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

The State of Maryland has chosen a corporate income tax system under which it imposes its tax on each separate corporate entity doing business within the State. Md. Ann. Code art. 81. It may be that there are instances in which the State could increase its revenues collected from particular corporations if it had chosen to use a combined unitary reporting system such as that used by California. *See Container, supra.* However, having chosen a system based on separate corporate entities, Maryland must live with that system. Thus, where a corporation employs subsidiaries to do business in States other than Maryland, that corporate separation must be recognized and the relationship between the parent and the subsidiaries cannot be used to extend jurisdiction. *See, Cannon Manufacturing Company v. Cudahy Packing Company*, 267 U.S. 333 (1925). Despite all precedent to the contrary, this is exactly what the State of Maryland is attempting to do in this case. The very purpose of the Due Process Clause is to assure fairness and equity in that there must be some concrete connection between a State and the entity over which it seeks to exert its jurisdiction. The decision of the lower court threatens this fundamental basis of due process and cannot be allowed to stand.

CONCLUSION

For the foregoing reasons, the Committee on State Taxation respectfully requests that the Petitioners' Petition for Writ of Certiorari be granted.

Respectfully submitted,

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